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C O N F I D E N T I A L SECTION 01 OF 05 BAKU 001472

SIPDIS

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EUR FOR DAS BRYZA AND S/P FOR STEVE HELLMAN
USDOE FOR CHARLES WASHINGTON
USDOC FOR 4212/ITA/MAC/CPD/CRUSNAK

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TAGS: [ECON](#) [EPET](#) [ENRG](#) [PREL](#) [AJ](#) [RU](#) [IR](#) [TU](#)

SUBJECT: EUR DAS BRYZA DISCUSSES ENERGY AND GAS TO EUROPE
WITH FINANCE MINISTER SHARIFOV

Classified By: AMBASSADOR ANNE E. DERSE, PER REASONS 1.4 (B, D)

¶1. (C) SUMMARY: EUR Deputy Assistant Secretary Matthew Bryza and Ambassador Derse met with Azerbaijani Minister of Finance Samir Sharifov October 2 to discuss Azerbaijan's expanding role as an international energy supplier and to press Minister Sharifov to begin discussions with the Government of Turkey on a bilateral gas transit agreement. Sharifov reiterated President Aliyev's decision and instruction that the GOAJ is fully committed to working with the U.S. to realize the Southern Corridor. Sharifov said that Azerbaijan would soon appoint a full-time energy ambassador (e.g., either himself or Energy Minister Natiq Aliyev) to lead the negotiations with Turkey while reiterating his intention to contact Turkish Energy Minister Guler once the budget process was complete. Sharifov complained to Bryza about recent issues with BP, including possible lower-than-expected oil volumes in the Baku-Tbilisi-Ceyhan pipeline. Sharifov briefed on Azerbaijan's relations with Kazakhstan and Turkmenistan, noting that relations with Turkmenistan have been strained due to a dispute over an outstanding Azerbaijani commercial debt to Turkmenistan and that President Aliyev has given permission for the GOAJ to begin discussions to resolve the dispute and improve bilateral relations. Sharifov said the GOAJ plans to develop a new petrochemical plant, noting that a U.S. firm was working on a feasibility study which would be finished by the end of 2006. DAS Bryza briefed Sharifov on his recent energy discussion with government officials in Turkey, Romania, Hungary and Greece, tying the discussion to the countries' need and desire to diversify their energy supplies with Azerbaijani gas. The Ambassador raised the upcoming EITI meeting in Oslo and told Sharifov that EB A/S Sullivan planned to attend. Sharifov said that he probably would not attend but that the State Oil Fund Executive Director would participate. END SUMMARY.

AZERBAIJAN-TURKEY

¶2. (C) EUR Deputy Assistant Secretary Matthew Bryza and Ambassador Derse met with Azerbaijani Minister of Finance Samir Sharifov October 2 to strategize on efforts to bring Azerbaijani natural gas to Europe. Sharifov stated that the U.S. and Azerbaijan share the same objective of obtaining a transit agreement with Turkey, adding that Azerbaijan will proceed with related technical assistance from the U.S. Trade Development Agency. Sharifov requested tangible and sustained U.S. engagement in the process, noting that

President Aliyev had instructed the GOAJ to work with the U.S. to realize the Southern Corridor of gas exports to Europe. DAS Bryza said he had followed Sharifov's advice in July to focus U.S. diplomatic efforts on a gas transit agreement between Azerbaijan and Turkey. Such an agreement, Sharifov had argued, provided the best insurance for gas producers and shippers in Azerbaijan that their gas could reach European markets regardless of whether Turkey agreed to increase gas imports from Russia via an expanded Blue Stream pipeline (under the Black Sea). Bryza said he had pressed Turkish Energy Minister Guler on the above points in mid-September, and that Guler had agreed to begin talks on a gas transit agreement with Azerbaijan. Bryza encouraged Sharifov to respond to Guler's invitation to him and Energy Minister Aliyev to begin such negotiations.

¶3. (C) Finance Minister Sharifov, who has handled energy policy for the Government of Azerbaijan since his tenure at the State Oil Fund, told DAS Bryza that at this juncture, Azerbaijan seeks bilateral negotiations with Turkey - and not yet multilateral talks with Greece, Italy, the Nabucco countries, and international energy companies. Sharifov dismissed Industry and Energy Natiq Aliyev's proposal of multilateral talks, calling it "wrong" and saying "we do not support a wider format at this point." He said that Azerbaijan is "ready to move forward" and that Foreign Minister Mammadyarov would soon see the President's appointment of a full-time energy negotiator to begin discussions with Turkey. Sharifov said he was cautiously optimistic that the GOAJ would name a regional energy envoy soon, to open discussions with the Turkish counterpart Ambassador Mithat Balkan.

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¶4. (C) DAS Bryza stressed to Sharifov the importance of contacting Ambassador Balkan and Turkish Energy Minister Guler to begin gas transit talks. Bryza stated that Guler had agreed with Bryza in mid-September to begin talks on a bilateral transit agreement with Azerbaijan. Bryza had argued with Guler that if Turkey did not obtain an agreement with Azerbaijan and instead moved towards expansion of the Blue Stream gas pipeline, Azerbaijani gas could be shut out of European markets for a long time. Guler stressed Turkey's desire to help their "brothers and sisters" in Azerbaijan, and agreed to pursue a gas transit agreement with Azerbaijan if the U.S. agreed to explore a possible working group among Baghdad, Ankara, and Washington on production and exports of natural gas in northern Iraq to Turkey and the rest of Europe. Guler also sought U.S. help in discouraging countries along the prospective Nabucco pipeline route from securing purchase prices for gas from Iran that were cheaper than the price Turkey pays for Iranian gas. Guler worried that such a situation would constitute a serious political liability for him and the GOT. Bryza told Sharifov that he replied to Guler that the U.S. did not favor any exports of Iranian gas to Europe via Nabucco or any other route. Sharifov stated that Iran has had gas supply problems to Turkey and probably could not meet any additional production export levels.

¶5. (C) Sharifov told Bryza that he had received an invitation from the Turkish Finance Minister to visit Turkey. Bryza responded that Sharifov should accept the invitation, as the protocol conscious Turks had arranged for Turkish Energy Minister Guler to invite Azerbaijani Energy Minister Aliyev, and for Turkish Finance Minister Unakitan to invite Azerbaijani Finance Minister Sharifov. Bryza added that Turkish Energy Minister Guler was aware that he had to talk with Sharifov on energy issues, but due to diplomatic protocol was bound to invite his Azerbaijani counterpart Industry and Energy Minister Aliyev. During the visit to Turkey, Sharifov would have an opportunity to talk with Minister Guler. Sharifov reiterated his intention to contact the Government of Turkey and Minister Guler as soon as the budget process was complete by early November.

AZERBAIJAN GAS RESERVES

¶ 16. (C) Bryza told Sharifov that representatives of gas consumer countries and gas producing companies believed that Azerbaijan did not have the gas reserves to realize the Turkey-Greece-Italy and/or Nabucco pipelines. Sharifov admitted that Shah Deniz Phase I gas supplies were insufficient, but argued that with Shah Deniz Phase II gas and Kazakhstan gas, there would be plenty to send on to Europe. He added that Azerbaijan could not replace Gazprom but that Azerbaijan needed to start now to begin discussions on gas deals that would allow production of sufficient gas volumes in 2015 for Azerbaijan to provide a significant option for diversified gas supplies to Europe. Sharifov noted that energy companies are reluctant to enter into long-term gas sales agreements without firm gas reserves data guaranteeing commercial commitments. He added that SOCAR may emerge as the most logical marketing agent of Shah Deniz gas.

This was due not only to SOCAR's corporate ambitions to secure a greater share of the value chain, but also to the reality of how "profit gas" is divided between Shah Deniz Consortium members and the Government of Azerbaijan. Under the existing production sharing agreement, international companies in the Shah Deniz Consortium receive a volume of gas for export that reflects an agreed monetary figure; thus, as international gas prices increase, the volume of gas available to individual companies for export decreases. Assuming international gas prices continue to increase, SOCAR -- rather than the international companies -- will be able to perform on long-term gas supply contracts from the Shah Deniz field.

¶ 17. (C) Bryza raised the idea of creating an "energy working group" in Azerbaijan, including international energy companies, that would meet to review Azerbaijan's growing role in international energy markets. Sharifov said that Azerbaijan could organize a working group, but appeared to prefer first to work through lingering commercial differences with BP. (See below.)

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GAZPROM

¶ 18. (C) Sharifov stated that Gazprom did not have enough gas to meet its sales commitments. Bryza agreed, adding that many analysts, including at the IEA, seemed to agree that based on Gazprom's purchase and sales agreements by 2010 and 2011, it may not have the gas. Bryza noted that the Government of Turkmenistan's contract with Gazprom extends only to 2009, potentially placing Gazprom in a bind in 2 winters. Sharifov and Bryza agreed that Gazprom may face pipeline infrastructure problems, given the need for billions of dollars in investment for maintenance that Gazprom has not been making. Sharifov noted that Gazprom was having difficulty obtaining enough gas and was now ready to pay higher prices for gas, citing the recent deal for Turkmen gas at USD 100 per thousand cubic meters.

AZERBAIJAN-BP PROBLEMS

¶ 19. (C) Sharifov briefed Bryza on recent problems Azerbaijan was experiencing with Azeri-Chirag-Gunesli field operator BP. Sharifov stated that BP is inflating its operating costs, including increasing its per-barrel production costs by 40 percent. Sharifov called this increase "unacceptable."

In addition, Sharifov said that according to BP, the Baku-Tbilisi-Ceyhan pipeline will not reach its designated pumping capacity of 1 to 1.5 million barrels per day as projected at the end of 2006, and was instead operating at a capacity of only 500,000 barrels per day. Sharifov added that BP has not provided any reasons for the problem and the

GOAJ "is concerned with the situation." Sharifov noted that the reduced volumes in BTC will have a negative effect on the GOAJ's budget by reducing revenues. He stated that BP is building up its capital expenditure costs for 2006, when these costs should actually be declining. DAS Bryza agreed to look into the situation, but -- at Sharifov's request -- not to take any further steps. COMMENT: In a regular monthly briefing for U.S. and UK Ambassadors, AIOC President David Woodward gave no hint of any SOCAR discontent with BP oil production. He did say that ACG production was increasing, and topped 580,000 bpd on a few days by the end of August. The BTC pipeline was moving approximately 500,000 bpd on its good days, although Woodward confessed that there were still "ups and downs." He said that BTC should be moving one million bpd in the FY07 first quarter.

PETROCHEMICAL PLANT

¶10. (C) Bryza apprised Sharifov of a proposal by Texas-based independent Moncrief Oil to develop shipments of compressed natural gas from Kazakhstan to Azerbaijan via barge. Richard Moncrief had told Bryza such an arrangement would cost around USD 100 million, and could ship 1 BCM per year. Sharifov thought such compressed natural gas shipments could feed a new petrochemical plant under consideration by the GOAJ. He said that a U.S. firm was working on a feasibility study which would be finished by the end of 2006. Sharifov hoped that the petrochemical plant could compete with similar ventures in the Middle East, but would be looking to supply Europe, not East Asia. He stated that Azerbaijan would look to purchase U.S. made equipment and technology and would provide products to domestic customers and Azerbaijan's neighbors, including Iran. On Iran, Sharifov asked Bryza and the Ambassador whether supplying Iran with petrochemicals from this plant would be a problem for the U.S. Bryza said that it was up to the Treasury Department's Office of Foreign Assets Control (OFAC), not the State Department, to determine whether such a transaction would violate the Iran Libya Sanctions Act, and that OFAC would require additional information to make a determination.

ROMANIA, HUNGARY AND GREECE

¶11. (C) DAS Bryza briefed Sharifov on his recent energy discussions with government officials in Romania, Hungary and Greece, tying the discussion to the need and desire of the countries to diversify their energy supplies with

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Azerbaijani gas. Bryza stated that the Romanians share U.S. and Azerbaijani aspirations for a Southern Corridor to feed Azerbaijani gas into the Nabucco pipeline. Government and corporate representatives in Hungary had told Bryza of energy giant MOL's dependence on Russian partners (especially Gazprom) for MOL's oil refining and natural gas businesses. But MOL's chief economist had expressed concern that predatory efforts by Russian energy companies to force out a Polish company at Lithuania's Mazeikiu refinery indicted a need for MOL and Hungary to diversify gas supplies away from Gazprom, and that Azerbaijan was a promising potential supplier. The MOL chief economist further noted that MOL's senior leadership seemed to have underestimated the difficulty of raising commercial financing for the Nabucco pipeline on the basis of Iranian gas supplies; doing business with Iran was simply too difficult; moreover, Iran seemed to lack sufficient gas supplies.

¶12. (C) Azerbaijan seemed to provide a more promising commercial alternative. MOL increasingly believed the best way to finance Nabucco might be through gas purchase agreements with individual members of the Shah Deniz Consortium. Such agreements dedicating pipeline capacity to a single company required partial exemptions from EU competition law. Securing such partial exemptions from the

European Commission was not difficult in the case of EU member states (e.g., Austria and Hungary today, and Romania and Bulgaria in a few months). Securing such a partial exemption for non-EU member Turkey would be more difficult. Bryza explained that the MOL economist believed that a Turkey-Azerbaijan gas transit agreement that was consistent with EU requirements for partial exemptions from competition law would resolve the problem. Bryza cited this as another reason why Sharifov was correct in arguing for a Turkey-Azerbaijan gas transit agreement as the crucial next step in developing the Southern Corridor.

¶13. (C) Turning to Greece, Bryza told Sharifov that the GOG was planning to privatize DEPA, the national natural gas utility company. Bryza asked if SOCAR had any thoughts about purchasing some part of DEPA, noting that Gazprom was ready to do the same. Sharifov expressed interest, saying he had not thought about it before, but would contemplate such an idea. Sharifov agreed that such an investment in DEPA might make it easier for SOCAR to market its gas in Greece via the Turkey-Greece-Italy pipeline.

AZERBAIJAN-TURKMENISTAN RELATIONS

¶14. (C) Sharifov told DAS Bryza that relations between Azerbaijan and Turkmenistan have been strained. He stated that there is an outstanding corporate debt dispute between AzeriGas and the Government of Turkmenistan that has hurt overall relations. Sharifov said that President Aliyev has given permission for the GOAJ to begin negotiations with Turkmenistan to resolve the debt dispute without admitting wrong-doing. Sharifov said that Azerbaijan is looking to improve relations with Turkmenistan, a country that could possibly link up with a trans-Caspian pipeline through Kazakhstan.

AZERBAIJAN-KAZAKHSTAN RELATIONS

¶15. (C) Turning to Kazakhstan's gas volumes and linking them into the South Caucasus Pipeline, Bryza stated that Kazakhstan wanted to participate, but that Timur Kulibayev, de-facto head of Kazakhstan's oil and gas sector, had run into Bryza in Turkey and noted that Kazakhstan lacked sufficient gas to commit to this scheme at this point. Kazakhstan will continue to export gas from the Karachaganak field to Russia (and the Orenburg processing facility) for years to come. Kazakhstan and its international corporate partners were reinjecting gas at Tengiz, and hoping to do the same at Kashagan. Kulibayev had said Kazakhstan hoped to export gas from additional fields in coming years to Europe via Azerbaijan, but that such gas might not be evident/available for the next five years. Bryza told Kulibayev this timeframe could work well, and wondered whether the GOKZ might occasionally note its interest in such a scheme. Kulibayev replied affirmatively. Sharifov agreed

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that Kazakhstan appeared to lack sufficient base gas at this time to factor into the Southern Corridor, but anticipated that such gas might be available in five years or so.

¶16. (C) The Ambassador raised the upcoming EITI meeting in Oslo and told Sharifov that EB A/S Sullivan planned to attend. Sharifov said that he probably would not attend but that the State Oil Fund Executive Director would participate.

The Ambassador also told Sharifov that U.S. Ambassador to the WTO Peter Allgeier planned to visit Azerbaijan mid-October and would be meeting with GOAJ officials to discuss WTO membership.

¶17. (U) DAS Bryza has cleared this message.
DERSE